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MasterCard International

Via Electronic Mail

March 28, 2005

Ms. Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

Re: Docket No. R-1217

Dear Ms. Johnson:

This letter is submitted on behalf of MasterCard International Incorporated ("MasterCard")[1] in response to the advance notice of proposed rulemaking ("ANPR") to commence a review of the open-end credit rules of Regulation Z that was published by the Federal Reserve Board ("Board") in the *Federal Register* on December 8, 2004. MasterCard appreciates the opportunity to provide its comments on the ANPR.

In General

MasterCard supports the Board's efforts to review the open-end provisions of Regulation Z. As the Board has noted in the ANPR, Regulation Z has not been reviewed in its entirety since the Truth in Lending Simplification Act of 1980. Given the development of open-end credit in the marketplace since that time, we believe it is appropriate and useful for the Board to consider necessary revisions to Regulation Z.

According to Congress, the purpose of the Truth in Lending Act ("TILA"), and therefore of Regulation Z, as it relates to open-end credit is: (i) to provide a meaningful disclosure of credit terms to enable consumers to compare more readily the various credit terms available and avoid the uninformed use of credit; and (ii) to protect the consumer against inaccurate and unfair credit billing and credit card practices. As part of the ANPR, the Board states that its primary goal "is to improve, if possible, the effectiveness and usefulness of open-end disclosures and substantive protections" as they relate to these intended purposes. MasterCard offers its comments with the same purposes in mind.

[1] MasterCard is an SEC-registered private share corporation that licenses financial institutions to use the MasterCard service marks in connection with a variety of payments systems.

Background

We believe it is critical that any review of Regulation Z be done in the proper context. In particular, the available evidence indicates that a large majority of consumers understand the key provisions of their credit card accounts. For example, a Federal Reserve Bulletin article entitled "Consumers and Credit Disclosures: Credit Cards and Credit Insurance" stated that 65% of consumers believe it is easy to obtain information about credit terms for general purpose credit cards while only 6% of consumers felt it was very difficult to obtain such information. Similarly, according to another Federal Reserve Bulletin article entitled "Credit Cards: Use and Consumer Attitudes, 1970-2000," 91% of consumers are generally satisfied with their credit card companies and 90% of consumers believe that their credit card companies treat them fairly. It is unlikely that these high satisfaction rates would exist unless the disclosures provided to consumers effectively communicate the terms and conditions under which the card programs operate.

In short, consumers' general understanding of, and satisfaction with, credit cards strongly suggests that Regulation Z is not "broken" with respect to ensuring that consumers understand the terms of open-end credit. Nonetheless, MasterCard believes that improvements can be made with respect to Regulation Z's disclosure requirements and we offer the following suggestions for making those improvements.

Format of Initial Disclosures

The Board correctly notes that the initial disclosures required by Section 226.6 of Regulation Z are generally included with the account agreement and any applicable state-law disclosures. This can result in the consumer receiving a document that is more than one or two pages in length that discusses fairly complex issues. For regulatory and legal reasons, it would be difficult to reduce the amount of information provided to the consumer as part of the account-opening process. However, the Board may wish to consider amending Regulation Z to ensure a more uniform disclosure of key credit terms in a manner that may be more easily used by the consumer. For example, a tabular disclosure of the key terms required to be disclosed under Section 226.6 at or near the front of the initial disclosures provided by the card issuer may be useful to consumers. To be effective, the tabular disclosure would need to be limited to only those terms that are of greatest importance to most consumers. In addition, it would be important for the Board to provide model language that can be used to summarize certain disclosures such as the language currently provided in Regulation Z for disclosing balance calculation methods in the "Schumer Box" disclosures. For example, the table of initial disclosures should be similar in format and level of detail to that currently provided with written Schumer Box disclosures.

It would also be important for the Board to implement any changes in a manner that considers the costs that would be imposed on card issuers. For example, requiring an additional table as part of the initial disclosures and providing sufficient time to implement the requirement, while not cost-free, may be justifiable in light of the costs associated with making such a change. Requiring a complete revision of the initial disclosures, and therefore the systems used to produce them, would be more difficult to justify.

Format of Periodic Statements

Although we believe that the Board could improve the method by which information is conveyed to consumers as part of the initial disclosures, MasterCard does not believe that any changes should be made with respect to the format of periodic disclosures required under Regulation Z. We are not aware of significant shortcomings associated with periodic disclosures. Indeed, it is our understanding that card issuers strive to make their periodic statements easier to read as a form of competition with other issuers. This has resulted in periodic statements that convey a significant amount of information in a concise and understandable manner to consumers. We do not believe that the continued evolution of periodic statements should be stifled by strict regulatory requirements mandating the format of periodic disclosures, other than those already imposed by Regulation Z.

It is also important to note that any significant revisions to periodic statements would require card issuers to incur significant costs. Aside from having to redesign the periodic statement, issuers would also have to revise the systems used to create and print such statements. Also, any changes that increase the length of a periodic statement typically result in higher mailing costs—costs which can be quite significant in view of the large volume of periodic statements mailed each month.

Classification of Fees as Finance Charges and Other Charges

One of the goals of TILA is to provide consumers with meaningful disclosures of key information that allows them to comparison shop. Another goal is to allow consumers to use credit in an informed manner. We believe that both of these goals can be better achieved by adopting clearer standards for classifying fees as "finance charges" or "other charges" (or neither). Section 106(a) of TILA states that the amount of a "finance charge" in connection with any consumer credit transaction is the sum of all charges "*imposed* directly or indirectly by the creditor as an incident to the extension of credit." (Emphasis added.) Under Section 226.4 of Regulation Z, the Board has adopted similar language stating that a "finance charge" is a charge "*imposed* directly or indirectly by the creditor as an incident to or a condition of the extension of credit." (Emphasis added.) Thus, based on the plain language of TILA and the corresponding portion of Regulation Z, in order to be a "finance charge," a charge must be "imposed" and it must be "an incident to or a condition of the extension of credit."

In order to provide for more uniform and meaningful disclosures to consumers, we urge the Board to return to the basic definition of "finance charge" as the guidepost for determining whether particular charges are or are not "finance charges." As noted above, under the plain language of TILA and Regulation Z, a fee must be "imposed" in order to be a "finance charge." This means that the term "finance charge" does not include any charge

unless it is "required" under the credit plan.[2] For example, the term "finance charge" does not include any fee charged by a creditor under an agreement which is not part of the credit plan. In addition, the term does not include any fee that the consumer may choose to avoid.[3]

Section 127 of TILA states that "[b]efore opening any account under an open-end consumer credit plan, the creditor shall disclose," among other things, "other charges which may be *imposed* as part of the plan." (Emphasis added.) Regulation Z states that the "amount of any charge other than a finance charge that may be *imposed* as part of the plan" must be disclosed as an "other charge" under TILA and Regulation Z. (Emphasis added.) Therefore, to be an "other charge," the charge must be "imposed" and it must be "part of the plan."

The Board appears to have deviated from the statutory and regulatory definition of "other charge" in some circumstances. For example, as part of a recent proposal to amend the Official Staff Commentary of Regulation Z, the Board staff indicated that an expedited payment fee would be an "other charge." The rationale for this position is that the fee "appears to be a significant charge related to the credit plan because the fee is for a service provided in connection with a consumer's payment on the account and because typically the fee is paid to enable the consumer to avoid a late payment fee that is also considered to be an 'other charge' for purposes of Regulation Z." The ANPR reiterates the concept that a fee that is not a finance charge but is "significant" is an other charge. The question of whether a particular charge is "significant" is debatable. As a result, using the "significance" of the fee to determine its treatment under Regulation Z is unlikely to provide sufficient clarity to ensure that necessary disclosures are appropriately and consistently presented to consumers. To address this issue, we respectfully suggest that the statutory and regulatory standard for determining whether a charge must be disclosed as an "other charge" is not based on whether a fee is "significant" but instead is based on whether the fee is "imposed" as part of the plan. Where the consumer can choose to avoid the fee, the fee should be neither a finance charge nor an other charge.

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[2] We note that such an interpretation of TILA and Regulation Z is consistent with the relevant case law addressing this issue and the definition of "impose." Courts have found that charges that were not required of the consumer are not "finance charges" under TILA. For example, the U.S. Court of Appeals for the 11th Circuit has stated that "[i]f the borrower can choose to avoid the...fee...then the fee is not imposed as an incident to the extension of credit." *Veale v. Citibank*, 85 F.3d 577, 579 (11th Cir. 1996), *cert. denied*, 1997 U.S. LEXIS 2711. Also, *Black's Law Dictionary* defines "impose" to mean "to levy or exact (a tax or duty)." Similarly, *Webster's Third New International Dictionary* defines "impose" to mean "to make, frame, or apply (as a charge, tax, obligation, rule, penalty) as compulsory, obligatory, or enforceable."

[3] Of course, the Board has discretion to identify particular fees that the Board believes should be included as a "finance charge" even where those fees are not imposed. For example, the Board has used this discretion to include fees for debt cancellation arrangements as "finance charges" in certain circumstances. To the extent that the Board determines that any other "voluntary" fees should be included in the definition of "finance charge," we urge the Board to do so by regulation making it clear that such voluntary finance charges are an exception to the general rule that a fee must be "imposed" in order to be a "finance charge."

Disclosure of Historical Annual Percentage Rate on Periodic Statements

Under Regulation Z, creditors must disclose a historical APR that includes any finance charges imposed during the billing cycle, including interest resulting from the application of the periodic rate. Non-interest rate finance charges must be amortized over one billing cycle for purposes of calculating the historical APR. As a result, the historical APR disclosed to the consumer may be much higher than the consumer's periodic rate.

The historical APR distorts the cost of credit to the consumer. In this regard, the historical APR has little to do with the actual cost imposed on the consumer. A relatively small finance charge may result in a deceptively high historical APR relative to the periodic rate if the amount of credit extended is also relatively small. Yet the *exact same finance charge* may have little effect on the historical APR relative to the periodic rate if the amount of credit extended is high. Such a result makes no sense if the goal is to allow the consumer to comparison shop, understand the cost of credit, and understand the creditor's billing practices. For example, if Creditor A charges $2 to make a cash advance and Creditor B charges $3, it would be logical to assume that the relevant disclosures provided to the consumer would reflect the fact that it is more expensive to obtain a cash advance from Creditor B than Creditor A. However, in this example, the cost of the cash advance likely has less impact on the historical APR than the amount of cash withdrawn by the consumer. For example, if all else is equal and the consumer withdraws $10 using a card issued by Creditor A, but $500 using a card issued by Creditor B, the historical APR suggests that the cost of credit is higher with respect to Creditor A when, in fact, Creditor A has lower fees than Creditor B. The inflated historical APRs that result on consumer's billing statements also result in a large number of customer service calls as consumers request an explanation of the historical APR. This suggests the historical APR is not effective in conveying the issuer's billing practices.

The Board notes that consumer advocates defend the historical APR because they believe it is an important disclosure because of its "shock value" and increasing the likelihood that consumers notice the fees they incur. We believe the goals of TILA can be met in a much more effective manner than requiring the disclosure of the historical APR. In this regard, consumers are already made aware of the finance charges they incur through existing disclosures provided on the periodic statement. To the extent the Board or others feel that these are ineffective in conveying information to consumers, that point can be debated and resolved in a more direct and efficient manner. However, using an indirect and deceptive disclosure such as the historical APR to "shock" consumers into learning more about the fees is inappropriate, inefficient, and contrary to the Board's goals in reviewing Regulation Z.

Disclosures of Rate Changes

The Board solicits comment about how consumers are informed of increased interest rates resulting from a consumer's default on the affected account or from a default on another account. In general, there are two circumstances in which such a so-called "penalty rate" increase may occur. First, the possibility for an increased interest rate resulting from the cardholder's actions may be part of the account terms. In this case, the

consumer would be made aware of the penalty rate as part of the Schumer Box, as part of the initial disclosures, and as part of the periodic disclosures if and when such a rate is used. Second, if the increased rate is not part of the account terms, the consumer must receive a change-in-terms notice before the new rate can be imposed. In many instances, the consumer also must receive adverse action notices under the Equal Credit Opportunity Act and the Fair Credit Reporting Act in addition to the change-in-terms notice. In short, we are not aware of any instance in which a penalty rate can be imposed, unless the consumer was informed of the rate in advance.

Issuance of Credit Cards

The ANPR includes a request for comment on whether the Board should revise Regulation Z to allow creditors to issue additional credit cards on an existing account at any time, even if there is no renewal or substitution of a previously issued card. MasterCard believes that the Board should revise Regulation Z to allow for card issuers to provide consumers with additional convenience and flexibility in the form of newer forms of credit cards on existing accounts while preserving existing consumer protections.

It is important to note that the technology of consumer payments continues to evolve. We believe Regulation Z should be amended to allow consumers to benefit from technological advances in a more efficient manner. For example, a card issuer should be permitted to send its cardholders new types of access devices on existing accounts without having to replace the device already in the cardholders' possession. We believe this provides obvious benefits to consumers, and it can be done in such a way so as to preserve existing cardholder liability protections.

We also urge the Board to consider whether it is always in the consumer's best interest to require a replaced card to be de-activated. MasterCard believes that, if the issuer does not wish to cancel the replaced card, the consumer should not be turned down at the point of sale if the consumer uses the replaced card instead of the new card. Again, we would also request that in amending Regulation Z, the consumer's liability for unauthorized use is not expanded.

Minimum Payment Disclosures

The Board solicits comment on issues related to minimum payment disclosures. This issue has been the subject of considerable debate in Congress over the last few years and the bankruptcy reform legislation passed by the Senate and pending in the House includes a carefully crafted compromise requiring new minimum payment disclosures. In view of the ongoing consideration of the bankruptcy bill, we urge the Board to withhold any consideration of the minimum payment disclosure issue until the fate of the bankruptcy legislation is resolved.

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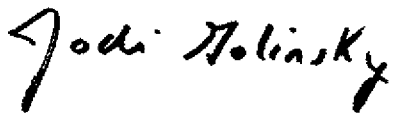
Once again, we appreciate the opportunity to comment on the Study. If you have any questions concerning our comments, or if we may otherwise be of assistance in connection with this issue, please do not hesitate to call me, at the number indicated above, or Michael F. McEneney at Sidley Austin Brown & Wood LLP, at (202) 736-8368, our counsel in connection with this matter.

Sincerely,



Jodi Golinsky
Vice President and
Senior Regulatory Counsel

cc: Michael F. McEneney, Esq.